

REPORT OF EXAMINATION

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

Seattle, Washington

As of December 31, 2001




Participating States:
Washington
Oregon

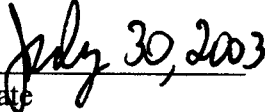
ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

CHIEF EXAMINER AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Rocky Mountain Fire & Casualty Company of Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 2001.



PATRICK H. McNAUGHTON
Chief Examiner



Date

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

TABLE OF CONTENTS

TABLE OF CONTENTS	1
SALUTATION	2
SCOPE OF EXAMINATION	3
INSTRUCTIONS	3
COMMENTS AND RECOMMENDATIONS	5
HISTORY	5
MANAGEMENT AND CONTROL	6
Board of Directors	6
Officers	7
AFFILIATED COMPANIES	7
CORPORATE RECORDS	8
INTERNAL SECURITY	9
Conflict of Interest	9
Fidelity Bond and Other Insurance	9
TERRITORY AND PLAN OF OPERATIONS	9
GROWTH OF COMPANY	9
REINSURANCE	10
ACCOUNTING RECORDS AND PROCEDURES	12
EDP SYSTEMS AND OPERATIONS	14
SUBSEQUENT EVENTS	14
FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS	15
FINANCIAL STATEMENTS	16
NOTES TO THE FINANCIAL STATEMENTS	23
ACKNOWLEDGMENT	26
AFFIDAVIT	27

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

Seattle, Washington
July 30, 2003

The Honorable Alfred W. Gross
Commissioner,
Commonwealth of Virginia
Chair, NAIC Financial Condition (EX)
Committee
State Corporation Commission
Bureau of Insurance
PO Box 1157
Richmond, VA 23218

The Honorable John Morrison
Commissioner, Montana Department of
Insurance
NAIC Secretary, Western Zone
840 Helena Avenue
Helena, MT 59601

The Honorable Mike Kreidler
Commissioner, Washington State Office of
Insurance Commissioner
5000 Capital Boulevard
PO Box 40255
Olympia, WA 98504-0255

Dear Commissioners:

In accordance with your instructions and in compliance with the statutory requirements of RCW 48.03.010, an examination was made of the corporate affairs and financial records of

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

of

Seattle, Washington

hereinafter referred to as "RMFCC" or the "Company," at the location of its home office, 200 Cedar Street, Seattle, WA 98121-1223. This report is respectfully submitted showing the condition of the Company as of December 31, 2001.

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

SCOPE OF EXAMINATION

This examination covers the period January 1, 1995 through December 31, 2001 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Insurance Code and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination.

INSTRUCTIONS

The examiners reviewed the Company's filed 2001 Annual Statement as part of the statutory examination. The review focused on determining if the Company's Annual Statement was completed in accordance with the Annual Statement Instructions published by the NAIC and on determining if the Company's accounts and records were prepared and maintained in accordance with Title 48 of the Revised Code of Washington and Title 284 of the Washington Administrative Code.

The following summarizes the exceptions noted while performing this review.

1. Intercompany Service Agreement

The Intercompany Service Agreement is dated March 11, 1986. The agreement is not specific as to what kinds of service the Grange Insurance Association provides to Rocky Mountain Fire & Casualty Company and the method of expense allocation.

These affiliate services performed by the Grange Insurance Association are required to be "fair and reasonable" as to terms and charges pursuant to RCW 48.31B.030(1)(a)(i)&(ii). In addition, RCW 48.31B.030(1)(a) requires: "(iii) Expenses incurred and payment received must be allocated to the insurer in conformity with customary insurance accounting practices consistently applied; (iv) The books, accounts, and records of each party to such transactions must be so maintained as to clearly and accurately disclose the nature and details of the transactions, including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties." (See Page 13, "Intercompany Service Agreement")

The Company is instructed to update the Intercompany Service Agreement to specifically outline the services Grange Insurance Association will perform for RMFCC. This formal agreement should be in written form, outline the services provided, allocation process, mode of repayment and timelines of the payment, as required by RCW 48.31B.030(1)(b)(iv).

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

The Company is instructed pursuant to RCW 48.31B.030(1)(b)(iv) to submit for approval to the Washington State Office of Insurance Commissioner an Intercompany Service Agreement with Grange Insurance Association which complies with RCW 48.31B.030(1)(a).

2. Outstanding Checks

The Company classifies outstanding checks as Drafts Outstanding. According to the NAIC Accounting Practices and Procedures Manual, SSAP No. 2, Paragraph 7, drafts and checks have different legal characteristics. A check is payable on demand, whereas a draft must be approved for payment by the reporting entity before it is honored by the bank. Because of these different characteristics, a draft meets the definition of a liability as defined by SSAP No. 5 — Liabilities, Contingencies and Impairments of Assets. Outstanding checks are accounted for as a reduction of cash. (See Page 13, "Outstanding Checks")

The Company is instructed to report its cash balance net of outstanding checks, in accordance with the NAIC Accounting Practices and Procedures Manual, SSAP No. 2, Paragraph 7 and RCW 48.05.073.

3. Guaranty Assessment

The Company did not accurately report its receivable for guaranty fund assessments that are subject to future premium tax offset. The receivable balance was under valued by \$24,125 for future offsets available in the state of Oregon. No examination adjustment was included since this amount is below the materiality level and deemed immaterial. (See Page 14, "Guaranty Assessment")

The Company is instructed to correctly record guaranty fund assessments as a receivable for future premium tax offsets, in accordance with each state's filing guidelines, RCW 48.05.250 and the NAIC Annual Statement Instructions.

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

COMMENTS AND RECOMMENDATIONS

1. Custodial Account and Agreement

The Custodial Agreement between the Company and Bank of New York Western Trust does not incorporate all the safeguards as suggested by the NAIC. The agreement does not include provisions for indemnifying the Company for lost securities. (See Page 13, "Custodial Agreement")

It is recommended the Company execute a custodial agreement with a bank, trust company or security depository that includes the required provisions for indemnifying the Association for lost securities, as presented by the NAIC Financial Condition Examiner's Handbook, Part 1 - General, IV. Conducting Examinations, Section J.

HISTORY

In 1956, Grange Insurance Association purchased the management contract of Mayflower Insurance Exchange of Seattle, Washington, and subsequently, on November 6, 1956, formed a wholly-owned subsidiary company named Mayflower Corporation to act as the attorney-in-fact to manage the insurance operations for the exchange.

In 1958, Mayflower Corporation acquired a majority (approximately 80% percent) of the outstanding stock of Rocky Mountain Fire Insurance Company of Great Falls, Montana. Effective April 2, 1959, Mayflower Corporation formed a new Washington insurance company called Rocky Mountain Fire & Casualty Company and on July 1, 1959, the previously acquired Montana insurance company was merged on a share-for-share basis into the new surviving Washington company. A simultaneous adjunct to this merger was the acquisition of all of the assets, liabilities and insurance obligations (through bulk reinsurance) of Mayflower Insurance Exchange by Rocky Mountain Fire & Casualty Company.

Capitalization

During the period covered by this examination, the par value of the Common Stock was changed on September 13, 1999 from \$165 per share to \$247 per share. There were 12,190 shares authorized and outstanding as of December 31, 2001.

The Grange Insurance Association made surplus contributions to the Company in the amounts of \$1,500,000 in 1980, \$2,500,000 in 1988, \$2,400,000 in 1990 and \$2,700,000 in 1993. The Company issued Surplus Contribution Notes to Grange Insurance Association in return.

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

The following schedule reflects the changes in the Company's capital structure from its inception to December 31, 2001:

<u>Year</u>	<u>Number of Shares Issued</u>	<u>Capital</u>	<u>Paid in Surplus</u>
1959	4,000	\$400,000	\$142,418
1961			350
1969	8,190	819,000	
1970		(560,740)	560,740
1973			(106)
1979		621,690	(621,690)
1994		731,400	
1999		999,580	
Total	<u>12,190</u>	<u>\$3,010,930</u>	<u>\$81,712</u>

No dividends were declared or paid to stockholders during the seven year period covered by the examination.

MANAGEMENT AND CONTROL

Board of Directors

The Bylaws of the Company state that the affairs of the Corporation shall be managed by a Board of Directors not in excess of fifteen in number. Article IV provides that no person shall be eligible for election to the Board of Directors who is not also a member of the Board of Directors of the Grange Insurance Association. Directors are elected at the annual stockholders' meeting and the terms of office are to be consistent with the dates of office of the corresponding terms of said directors serving as directors of the Grange Insurance Association. The Bylaws require that the Board meet immediately following the annual stockholders' meeting and that the Board shall have not less than three additional regular meetings each Board year.

The Bylaws state that the Board of Directors shall select an Executive Committee consisting of the President, Vice President of the Board and three Directors who shall have the full power to act for the Board between meetings, except as the Board may otherwise direct. The Board may designate other permanent or temporary committees and delegate thereto such powers as deemed necessary.

The officers of the Company shall be elected by the Directors and shall consist of the President, one or more Vice Presidents, a Secretary, a Treasurer, one or more Assistant Secretaries, and one or more Assistant Treasurers. The same individual may hold at the

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

same time any two offices except for those of President and Vice President. Only the President and Vice President shall be elected from among the members of the Board.

The following Directors were elected to serve the Company as of December 31, 2001:

Donald L. Wade	Past President - GIA
Larry D. Tanneberg	President - Larry Tanneberg Farms and Tanneberg Insurance Agency
Frederick P. Church	Past President - GIA; Secretary and Vice Chairman-People's Community Credit Union
Arthur R. Peterson	Owner - Art Peterson Insurance Agency
Randall A. Lewis	Owner - Lewis Insurance Agency; Captain - Los Angeles Fire Department
Donald A. Steffen	Retired Dairy Farmer
Myrtle J. Reed	Master - Roxy Ann Grange
Rosemary K. Hansen	Owner/Manager of commercial properties; Retired Insurance Agent
Benjamin D. Metzler	President of GIA
Ronald G. Miller	Retired from GIA
D. Thomas McKern	Owner/operator - McKern Farms
Darelld B. Larrigan	Retired Grange Member; Former Marketing Manager - GIA.
Robert L. Shea	Retired Insurance Agent - GIA

Officers

The principal executive officer of the Company is Ryan M. Dudley, Executive Vice President. Mr. Dudley has been with the Company for more than ten (10) years.

The following Officers were elected to serve the Company as of December 31, 2001:

Benjamin D. Metzler	President
Ryan M. Dudley	Executive Vice President
David E. Suver	Secretary
Sean I. McGourty	Chief Financial Officer

AFFILIATED COMPANIES

Rocky Mountain Fire & Casualty Company and its affiliates are members of a holding company system regulated pursuant to Chapter 48.31B RCW. The affiliate companies are required to file holding company statements under RCW 48.31B.25(1)(c), RCW 48.31B.025(3), WAC 284-18-390 and WAC 284-18-400. Within the holding company

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

structure, RMFCC is controlled through direct and indirect stock ownership by the affiliates listed below:

Grange Insurance Association

Grange Insurance Association (GIA) was organized on April 19, 1894 and has the authority to transact insurance business as a fraternal mutual insurer for the purpose of insuring only the risks of members of Patrons of Husbandry (Grange members). GIA owns all 1,000 shares of the authorized common stock of Mayflower Corporation.

Mayflower Corporation

Mayflower Corporation, an insurance holding company, was created by the management of GIA and was incorporated under the laws of the state of Washington on November 6, 1956. All 1,000 shares of its authorized common stock are wholly-owned by GIA. On April 2, 1959, Mayflower Corporation created a new property and casualty stock insurance company called Rocky Mountain Fire & Casualty Company. As of December 31, 2001, Mayflower Corporation owned 99.89% of the outstanding common stock shares of RMFCC.

The affiliates have Federal Income Tax and Intercompany Expense Sharing Agreements among the affiliates which include but are not limited to the following:

- Federal Income Taxes
- Claims Administration Services
- Investment Services
- Data Processing and Accounting Services
- Personnel and Related Services
- Underwriting and Policy Service Functions

CORPORATE RECORDS

The minutes of all meetings held by Stockholders, the Board of Directors and the Executive Committee were reviewed for the period being examined. The minutes gave a clear and concise record of the official actions taken at such meetings and indicated that the members were in regular attendance and took an active interest in the affairs of the Company. A quorum was present at all meetings. It was noted during our review that the Articles of Incorporation were amended once in 1999 to increase the par value of the Common Stock from \$165 to \$247. The Bylaws were changed several times during the examination period. These changes related to the composition and election of members of the Executive Committee.

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

INTERNAL SECURITY

Conflict of Interest

Rocky Mountain Fire & Casualty Company has an established procedure for disclosure to its Board of Directors of any affiliation on the part of its officers, directors and key employees which is in conflict with their official duties. The Corporate Secretary, Executive Vice President, and President review the Conflict of Interest Statements annually for conflicting situations and take appropriate action thereupon.

Fidelity Bond and Other Insurance

Rocky Mountain Fire & Casualty Company and its affiliate companies are the named insureds on various insurance policies including property and general liability loss, difference in conditions, commercial excess umbrella liability, excess liability, workers' compensation and employers' liability, fidelity, fiduciary liability, errors and omissions and directors and officers' liability coverage.

The fidelity coverage of \$1,000,000 meets the suggested NAIC minimum coverage.

TERRITORY AND PLAN OF OPERATIONS

Rocky Mountain Fire & Casualty Company is authorized to do business in California, Colorado, Idaho, Montana, Oregon, Washington, and Wyoming.

GROWTH OF COMPANY

The following schedules reflect the growth of the Company by year beginning in 1995. The amounts shown were compiled from the Company's filed Annual Statements:

Schedule 1

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Surplus & Other Funds</u>
2001	34,640,008	22,145,632	12,494,376
2000	31,860,972	17,910,422	13,950,550
1999	26,025,848	11,749,153	14,276,695
1998	22,346,952	8,108,610	14,238,342
1997	19,891,818	6,251,310	13,640,507
1996	18,821,148	6,241,152	12,579,996
1995	18,708,704	7,298,700	11,410,004

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

Schedule 2

		Net			
<u>Year</u>	<u>Premiums Earned</u>	<u>Underwriting Deductions</u>	<u>Underwriting Gain or Loss</u>	<u>Investment and Other Income</u>	<u>Pre-Tax Income</u>
2001	23,789,986	27,647,726	(3,857,739)	1,769,400	(2,088,339)
2000	16,541,675	18,350,398	(1,808,723)	1,812,623	3,900
1999	10,597,351	11,801,014	(1,203,663)	1,474,812	271,149
1998	7,418,728	8,043,003	(624,276)	1,392,282	768,006
1997	6,256,812	6,004,856	251,957	1,337,832	1,589,788
1996	6,069,568	5,809,206	260,362	1,320,494	1,580,856
1995	5,956,164	5,809,457	146,707	1,244,253	1,390,960

REINSURANCE

Rocky Mountain Fire & Casualty Company participates in quota share and catastrophe treaties. Each of these treaties is spread across an extensive portfolio of reinsurers, limiting any concentrated assumed risk.

Following is a summary of the terms and conditions of RMFCC reinsurance program:

Property & Casualty – Inter-company (Per Risk Ceded)

Coverage: RMFCC - \$100,000 excess of \$150,000 retention

Rate: 2.25% of subject earned premium

Reinsurer: Grange Insurance Association

Comments: Rate increased from 2.15%, January 1, 2000, based on loss experience.

Property & Casualty (Per Risk)

Coverage: Property - \$2,250,000 excess of \$250,000 retention.
Casualty - \$2,750,000 excess of \$250,000 retention.

Rate: 1.695% of subject earned premium (First Excess 1.52%, Second Excess 0.175%)

Reinsurer: Swiss Re America

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

Profit Sharing: (First Excess layer only) 50% of the reinsurer's net profit for each underwriting year within a three year period, after 15% expense.

Comments: Treaty renewed for 2000 and 2001 at the same limits, rate, and conditions as 1999.

Property Catastrophe (Per Occurrence)

Coverage: 95% of \$19,000,000 excess of \$2,000,000 retention.

Rate: 3.511% of subject earned premium (Note: SEP is net after deducting the cost of the single risk program).

Reinsurer: Lloyds provides over 75% of the cover. The remaining coverage is provided by CNA, GE, and R & V Versicherung.

Note: John B. Collins Associates, Inc., broker for this program.

Comments: Rate and limits were unchanged from the 2000 contract.

Umbrella Excess Liability Quota Share

Coverage: 92.5% of the amount of net loss allocated to the first \$1,000,000 of coverage and 100% of the amount of net loss for policy limits in excess of \$1,000,000.

Rate: 92.5% of the direct written premium charged by the Company for policy limits up to and including \$1,000,000, and 100% of the direct written premium charged by the Company for policy limits in excess of \$1,000,000.

Commission Rate: 30%

Reinsurer: General Reinsurance Corporation

Comments: Coverage and rate unchanged from 2000.
The company issues policies up to \$5,000,000.

Reinsurance Intermediary

Rocky Mountain Fire & Casualty Company utilizes the services of a reinsurance intermediary, John B. Collins Associates, Inc., to solicit, negotiate, and place reinsurance cessions on behalf of the company. A review of the contracts and licenses of the

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

reinsurance intermediary noted that the intermediary is licensed by Minnesota but not by Washington State, which is permitted according to RCW 48.94.010(1) (b).

ACCOUNTING RECORDS AND PROCEDURES

Rocky Mountain Fire & Casualty Company maintains its accounting records on a Generally Accepted Accounting Principles (GAAP) modified accrual basis of accounting and adjusts to Statutory Accounting Practices (SAP) basis for Annual Statement reporting.

The Annual Statements filed with the Washington State Office of Insurance Commissioner during the examination period were examined and reviewed to verify that they were prepared in a manner consistent with the statutory requirements of Title 48 Revised Code of Washington, Title 284 Washington Administrative Code, the standards and procedures required or prescribed by the Washington State Office of Insurance Commissioner and the National Association of Insurance Commissioners. The following areas deviated from these standards and procedures:

Losses and Loss Adjustment Expenses

The reserves carried by the Company for these liabilities were \$8,037,864 and \$1,197,387, respectively, as of December 31, 2001.

The reserves were reviewed by the casualty actuarial staff of the OIC. Company personnel provided loss and loss adjustment expense development data by line of business as of December 31, 2002. (In other words, the data included 12 months of development subsequent to the examination period.) Company personnel provided additional information by electronic mail and in a face-to-face meeting. Actuarial staff also reviewed an actuarial report prepared by the Company's consulting actuarial firm, Milliman USA, Inc.

Based on their analysis of data through December 31, 2002, the OIC's actuarial staff concluded that the Company's booked reserves were deficient as of December 31, 2001. Since December 31, 2001, the Company has taken significant steps to strengthen its loss and loss adjustment expense reserves for 2001 and prior years. These steps are reflected in the one-year loss development of \$1,775,000 shown on Page 23 of the Company's Annual Statement for 2002.

The OIC's actuarial staff recommends the following examination adjustments to reserves as of December 31, 2001:

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

	<u>Booked Reserve</u>	<u>Examination Adjustment</u>	<u>Restated Reserve</u>
Losses	\$8,037,864	\$1,309,000	\$9,346,864
Loss adjustment expenses	1,197,387	466,000	1,663,387

Custodial Agreement

The Custodial Agreement between the Company and Bank of New York Western Trust does not incorporate all the safeguards as suggested by the NAIC. Specifically, the agreement should include the following:

- That the bank or trust company as custodian is obligated to indemnify the insurance company for any loss of securities of the insurance company in the bank or trust company's custody.
- In the event of a loss of the securities for which the bank or trust company is obligated to indemnify the insurance company, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced.

(See Comments and Recommendations No. 1)

Intercompany Service Agreement

The Intercompany Service Agreement is dated March 11, 1986. The agreement is not specific as to what kinds of service the Grange Insurance Association provides to Rocky Mountain Fire & Casualty Company and the method of expense allocation.

These affiliate services performed by the Grange Insurance Association are required to be "fair and reasonable" as to terms and charges pursuant to RCW 48.31B.030(1)(a)(i)&(ii). In addition, RCW 48.31B.030(1)(a) requires: "(iii) Expenses incurred and payment received must be allocated to the insurer in conformity with customary insurance accounting practices consistently applied; (iv) The books, accounts, and records of each party to such transactions must be so maintained as to clearly and accurately disclose the nature and details of the transactions, including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties." (See Instructions No. 1)

Outstanding Checks

The Company classifies outstanding checks as Drafts Outstanding. According to the NAIC Accounting Practices and Procedures Manual, SSAP No. 2, Paragraph 7, drafts and

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

checks have different legal characteristics. A check is payable on demand, whereas a draft must be approved for payment by the reporting entity before it is honored by the bank. Because of these different characteristics, a draft meets the definition of a liability as defined by SSAP No. 5 — Liabilities, Contingencies and Impairments of Assets. Outstanding checks are accounted for as a reduction of cash. (See Instructions No. 2)

Guaranty Assessment

The Company did not accurately report its receivable for guaranty fund assessments that are subject to future premium tax offset. The receivable balance was under valued by \$24,125 for future offsets available in the state of Oregon. No examination adjustment was included since this amount is below the materiality level and deemed immaterial. (See Instructions No. 3)

EDP SYSTEMS AND OPERATIONS

The management of RMFCC is sufficiently knowledgeable of EDP issues and the various department managers work with the IS Department to provide direction and oversight. Systems Development, Acquisition and Maintenance Controls were evaluated to gain assurance that programs and systems are designed, tested, approved and implemented using appropriate controls. The Company has detailed written documentation for its major operations and financially significant applications. There is proper supervision and review for each project to ensure satisfactory completion.

SUBSEQUENT EVENTS

1. Paid in Capital

In the Board Minutes of June 6, 2002, it was noted that the OIC had notified RMFCC that its surplus was not adequate to continue writing business. The Board of GIA authorized an \$8.37 million transfer to RMFCC. A review of the filed Quarterly Statement for June 30, 2002, reflected the transfer as Paid in Capital.

2. Reinsurance

The reinsurance contract with Swiss Re was terminated effective January 1, 2002 and will be replaced by GMAC. GMAC will provide the same coverage to the Company and will increase the retention levels to \$500,000.

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

The Grange reinsurance limit assumed for the intercompany reinsurance agreement with RMFCC increased to \$350,000. The retention limit for the Inter-company reinsurance contract with Grange Insurance Association remained the same at \$150,000. The reinsurance rate increased from 2.25% to 4.05% to reflect the increase in reinsurance limit from \$100,000 to \$350,000.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

The prior exam dated December 31, 1994, included the following recommendations:

1. Disaster Responses Plan

It was recommended that the Company establish a disaster plan for the use of alternative facilities. It was recommended that such a plan be established and rehearsals should periodically be conducted to test the adequacy of the plan.

After the prior examination, the Company began the process of writing a disaster recovery plan that was to include the use of an alternate site for processing. A committee consisting of individuals from each department was assigned to write, test and implement the plans. In 1996, before the plan was completed and implemented, the committee was disbanded by Senior Management due to a lack of funds and a change in priorities caused by operating losses. Progress on the plan was never resumed.

During the current examination, GIA signed an agreement with Ernst & Young, LLP, to assist the Company in preparing and testing a plan. The plan has been completed and reviewed by the examiners but has not yet been tested.

2. Documentation

It was recommended that the Company document all programs and procedures.

The Company responded to this recommendation by improving program documentation.

3. Personal Computer Controls

It was recommended that the Company install virus detection programs, update them periodically and use them regularly on all personal computers to detect computer viruses.

Currently, virus protection software is being used by the Company.

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

4. Federal Income Taxes

It was recommended that the Company amend the Inter-Company Federal Income Tax Agreement to state that no company will be worse off than it would be on a stand alone or separate return basis, and the Company should keep track of inter-company utilization of tax benefits, such as net operating loss carry forwards.

The Company responded to this recommendation by amending the agreement to reflect these changes.

FINANCIAL STATEMENTS

The following examination financial statements show the financial condition of RMFCC as of December 31, 2001:

Statement of Assets, Liabilities, Surplus and Other Funds
Underwriting and Investment Exhibit
Analysis of Examination Changes in Financial Statements
Comparative Statement of Assets, Liabilities, Surplus and Other Funds
Comparative Underwriting and Investment Exhibit
Seven Year Reconciliation of Surplus and Other Funds

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

Statement of Assets, Liabilities, Surplus and Other Funds December 31, 2001

	<u>Balance</u> <u>Per Company</u>	<u>Adj.</u> <u>No.</u>	<u>Examination</u> <u>Adjustments</u>	<u>Ref.</u>	<u>Balance Per</u> <u>Examination</u>
Assets					
Bonds	\$28,023,937			(2A)	\$28,023,937
Stocks:					
Preferred stocks	253,125			(2B)	253,125
Cash and short term investments	1,890,629	(1)	\$(1,246,551)	(2C)	644,078
Agents' balances or uncollected premiums					
Premiums and agents' balances in course of collection	3,601,041			(4)	3,601,041
Reinsurance recoverable on loss adjustment expense payment	86,844				86,844
Federal income tax recoverable and interest thereon	408,076			(4)	408,076
Interest, dividends and real estate income due and accrued	376,356				376,356
Total assets	<u>\$34,640,008</u>		<u>\$(1,246,551)</u>		<u>\$33,393,457</u>
Liabilities, surplus and other funds					
Losses	\$8,037,864	(2)	\$1,309,000	(5)	\$9,346,864
Losses adjustment expenses	1,197,387	(3)	466,000	(5)	1,663,387
Commission payable, contingent commissions and other similar charges	6,496				6,496
Other expenses (excluding taxes, licenses and fees)	153,250				153,250
Taxes, licenses and fees (excluding federal and foreign income taxes)	191,901				191,901
Unearned premiums	10,032,193				10,032,193
Ceded reinsurance premiums payable	382,564				382,564
Amount withheld or retained by company for account of others	34,622				34,622
Draft outstanding	1,246,551	(1)	(1,246,551)		0
Payable to parent	506,703				506,703
Aggregate write-ins for liabilities	356,101				356,101
Total liabilities	<u>22,145,632</u>		<u>528,449</u>		<u>22,674,081</u>
Common capital stock	3,010,930				3,010,930
Surplus notes	9,100,000				9,100,000
Unassigned funds	383,446	(2, 3)	(1,775,000)		(1,391,554)
Total surplus as regards policyholders	<u>12,494,376</u>		<u>(1,775,000)</u>		<u>10,719,376</u>
Total liabilities, surplus and other funds	<u>\$34,640,008</u>		<u>\$(1,246,551)</u>		<u>\$33,393,457</u>

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

Underwriting and Investment Exhibit Statement of Income For the Year Ended 2001

	<u>Balance</u> <u>Per Company</u>	<u>Ref</u>	<u>Adjustments</u>	<u>Balance</u> <u>Per Exam</u>
Premiums earned	\$23,789,986			\$23,789,986
Deductions				
Loss incurred	18,743,180	(2)	\$1,309,000	20,052,180
Loss expenses incurred	2,087,261	(3)	466,000	2,553,261
Other underwriting deductions	6,817,285			6,817,285
Total underwriting deductions	<u>27,647,726</u>		<u>1,775,000</u>	<u>29,422,726</u>
Net underwriting gain or (loss)	(3,857,739)		(1,775,000)	(3,857,739)
Investment Income				
Net investment income earned	1,471,284			1,471,284
Net realized capital gains or (losses)	48,335			48,335
Net investment gain or (loss)	<u>1,519,619</u>			<u>1,519,619</u>
Other Income				
Net gain or (loss) from agents' or premium balances charged off	(26,467)			(26,467)
Finance and service charges not included in premiums	275,122			275,122
Aggregate writs-ins for miscellaneous income	1,126			1,126
Total Other Income	<u>249,781</u>			<u>249,781</u>
Net income before dividends to policyholders but before federal and foreign income taxes	(2,088,339)		(1,775,000)	(3,863,339)
Federal and foreign income taxes incurred	(146,541)			(146,541)
Net Income	<u><u>\$ (1,941,798)</u></u>		<u><u>\$ (1,775,000)</u></u>	<u><u>\$ (3,716,798)</u></u>
Capital and Surplus Account				
Surplus as regards policyholders, December 31, 2000	<u><u>\$13,950,550</u></u>			<u><u>\$13,950,550</u></u>
Gains and (losses) in surplus				
Net income	(1,941,798)		\$ (1,775,000)	(3,716,798)
Change in net deferred income tax	376,470			376,470
Change in nonadmitted assets	(863,541)			(863,541)
Cumulative effects of changes in accounting principles	992,059			992,059
Aggregate write-ins for gains and losses in surplus	(19,363)			(19,363)
Change in surplus as regards policyholders for the year	<u>(1,456,173)</u>		<u>(1,775,000)</u>	<u>(3,231,173)</u>
Surplus as regards policyholders, December 31, 2001	<u><u>\$12,494,376</u></u>		<u><u>\$ (1,775,000)</u></u>	<u><u>\$10,719,376</u></u>

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

Analysis of Examination Changes in Financial Statements December 31, 2001

	<u>Adj.</u> <u>No.</u>	<u>Increase/</u> <u>(Decrease)</u>	<u>Balance</u> <u>Per Exam</u>
Surplus as regards policyholders, per company			\$12,494,376
Assets			
Cash and short term investments			
Outstanding checks recorded as a liability	(1)	\$(1,246,551)	
Liabilities			
Losses			
Reserves were deficient	(2)	(1,309,000)	
Loss adjustment expenses			
Reserves were deficient	(3)	(466,000)	
Draft outstanding			
Outstanding checks recorded as a liability	(1)	<u>1,246,551</u>	
Net increase/(decrease) to surplus			<u>(1,775,000)</u>
Surplus as regards policyholders, per examination			<u>\$10,719,376</u>

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

Comparative Statement of Assets, Liabilities, Surplus and Other Funds For December 31,

Assets	<u>2001*</u>	<u>2000</u>
Bonds	\$28,023,937	\$24,656,527
Stocks:		
Preferred stocks	253,125	253,125
Cash and short term investments	644,078	2,863,023
Agents' balances or uncollected premiums		
Premiums and agents' balances in course of collection	3,601,041	2,451,668
Premiums, agents' balances and installments booked but deferred and yet due	0	1,207,903
Reinsurance recoverable on loss adjustment expense payment	86,843	5,352
Federal income tax recoverable and interest thereon	408,076	9,724
Interest, dividends and real estate income due and accrued	376,356	413,650
Total assets	<u>\$33,393,457</u>	<u>\$31,860,972</u>
Liabilities, surplus and other funds		
Losses	\$9,346,864	\$5,446,821
Losses adjustment expenses	1,663,387	998,326
Commission payable, contingent commissions and other similar charges	6,496	0
Other expenses (excluding taxes, licenses and fees)	153,250	83,019
Taxes, licenses and fees (excluding federal and foreign income taxes)	191,901	186,567
Federal and foreign income taxes	0	84,219
Unearned premiums	10,032,193	8,832,333
Ceded reinsurance premiums payable	382,564	0
Amount withheld or retained by company for account of others	34,622	20,202
Provision for reinsurance	0	192,000
Draft outstanding	0	819,068
Payable to parent	506,703	1,247,868
Aggregate write-ins for liabilities	356,101	0
Total liabilities	<u>22,674,081</u>	<u>17,910,422</u>
Common capital stock	3,010,930	3,010,930
Aggregate write-ins for other than special surplus funds	9,100,000	9,100,000
Unassigned funds	(1,391,554)	1,839,620
Total surplus and other funds	<u>10,719,376</u>	<u>13,950,550</u>
Total liabilities, surplus and other funds	<u>\$33,393,457</u>	<u>\$31,860,972</u>

* = Audited balances.

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

Comparative Underwriting and Investment Exhibit Statement of Income For the Years Ended December 31,

	2001*	2000
Premiums earned	\$23,789,986	\$16,541,675
Deductions		
Loss incurred	20,052,180	12,046,880
Loss expenses incurred	2,553,261	1,414,924
Other underwriting deductions	6,817,285	4,888,593
Total underwriting deductions	<u>29,422,726</u>	<u>18,350,398</u>
Net underwriting gain or (loss)	(3,857,739)	(1,808,723)
Investment Income		
Net investment income earned	1,471,284	1,664,303
Net realized capital gains or (losses)	48,335	(35,737)
Net investment gain or (loss)	<u>1,519,619</u>	<u>1,628,566</u>
Other Income		
Net gain or (loss) from agents' or premium balances charged off	(26,467)	(7,088)
Finance and service charges not included in premiums	275,122	189,740
Aggregate write-ins for miscellaneous income	1,126	1,406
Total Other Income	<u>249,781</u>	<u>184,057</u>
Net income before dividends to policyholders but before federal and foreign income taxes	(3,863,339)	3,900
Federal and foreign income taxes incurred	(146,541)	167,916
Net Income	<u><u>\$ (3,716,798)</u></u>	<u><u>\$ (164,016)</u></u>
 CAPITAL AND SURPLUS ACCOUNT		
Surplus as regards policyholders, December 31, 2000	<u><u>\$13,950,550</u></u>	<u><u>14,276,695</u></u>
Gains and (losses) in surplus		
Net income	(3,716,798)	(164,016)
Change in net deferred income tax	376,470	0
Change in nonadmitted assets	(863,541)	(144,018)
Cumulative effects of changes in accounting principles	992,059	0
Aggregate write-ins for gains and losses in surplus	(19,363)	(18,112)
Change in surplus as regards policyholders for the year	<u><u>(3,231,173)</u></u>	<u><u>(326,145)</u></u>
Surplus as regards policyholders, December 31, 2001	<u><u>\$10,719,376</u></u>	<u><u>\$13,950,550</u></u>

* = Audited balances.

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

Seven Year Reconciliation of Surplus For the Years Ended December 31,

	<u>2001*</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>	<u>1995</u>
Surplus as regards policyholders, December 31, previous	\$13,950,550	\$14,276,695	\$14,238,342	\$13,640,509	\$12,579,996	\$11,410,005	\$9,841,626
Net income	(3,716,798)	(164,016)	173,737	436,915	1,303,507	1,297,591	1,390,960
Change in net deferred income tax	376,470	0	0	0	0	0	0
Change in nonadmitted assets and related items	(863,541)	(144,018)	(95,265)	(30,243)	382	(92,669)	(19,012)
Change in excess of statutory reserve over statement reserve	0	0	(40,000)	181,000	(250,000)	(84,000)	96,000
Capitals changes, transfer from surplus	0	0	999,580	0	0	0	0
Cumulative effects of change in accounting Principles	992,059	0	0	0	0	0	0
Aggregate write-ins for gains and losses in Surplus	(19,363)	(18,112)	(999,699)	10,163	6,624	49,069	100,431
Net change in capital and surplus for the year	(3,231,173)	(326,145)	38,353	597,834	1,060,512	1,169,991	1,568,379
Surplus as regards policyholders, December 31, current	\$10,719,376	\$13,950,550	\$14,276,695	\$14,238,343	\$13,640,509	\$12,579,996	\$11,410,005

* = Audited balances.

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

NOTES TO THE FINANCIAL STATEMENTS

1. Basis of Presentation

The financial statements included herein have been prepared in accordance with accounting practices prescribed or permitted by the Washington State Office of Insurance Commissioner. Prescribed statutory accounting practices include a variety of publications of the NAIC, as well as state laws, regulations, and general administrative rules.

2. Investments

Investments are valued based on the NAIC's Valuation of Securities Manual and Chapter 48.12 of the Revised Code of Washington.

A. Bonds

Bonds are generally reported at amortized cost using the scientific method, which closely approximates the effective interest method. The audited statement values, unrealized gains and losses, estimated market values and acquisition cost of bonds held for investment as of December 31, 2001 were as follows:

	Statement Value	Unrealized Gains/ (Losses)	Market Value	Actual Cost
U.S. Government	\$5,378,705	\$7,153	\$5,385,858	\$5,393,089
States and Territories	968,320	11,591	979,911	973,088
Public Utilities	48,000	0	48,000	241,500
Political Subdivisions	2,534,996	102,922	2,637,918	2,544,153
Special Revenue	4,697,857	67,361	4,765,218	4,728,809
Industrial & Misc.	<u>14,396,059</u>	<u>179,394</u>	<u>14,575,453</u>	<u>14,492,304</u>
Total	<u>\$28,023,937</u>	<u>\$368,422</u>	<u>\$28,392,359</u>	<u>\$28,372,944</u>

The maturity distribution of all bonds and short term investments owned as of December 31, 2001 was as follows:

	Statement Value	Percent of Portfolio
Due in one year or less	\$ 6,890,558	23.69%
Due over one year through five years	11,762,739	40.43%
Due over five years through ten years	4,688,616	14.40%
Due over ten years through twenty years	2,988,642	10.27%
Over twenty years	<u>3,261,608</u>	<u>11.21%</u>
Total	<u>\$ 29,592,163</u>	<u>100.00%</u>

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

The NAIC Securities Valuation Office's classification distribution as of December 31, 2001 was as follows:

	Statement Value	Percent of Portfolio
Class 1	\$27,813,543	93.89%
Class 2	1,593,120	5.48%
Class 3	137,500	0.47%
Class 6	48,000	0.16%
Total	<u>\$29,592,163</u>	<u>100.00%</u>

B. Preferred Stocks

Preferred stocks are valued at market. The Book Value, Unrealized Gains and Losses, Estimated Market Values and Actual Cost of common stocks held as of December 31, 2001 were as follows:

	Book Value	Unrealized Gains/ (Losses)	Market Value	Actual Cost
Preferred Stocks	\$253,125	\$0	\$253,125	\$253,125

C. Cash and Short-Term Investments

Short-term investments include securities acquired within one (1) year of maturity and are reported at amortized cost, which approximates market value. The statement value of Cash and Short-Term Investments, as of December 31, 2001 were as follows:

Cash	\$(924,147)
Short-Term Investments	<u>1,568,225</u>
Total	<u>\$ 644,078</u>

3. Information Concerning Parent, Subsidiaries and Affiliates

Grange Insurance Association owns all of the outstanding shares of Mayflower Corporation, an insurance holding company domiciled in the state of Washington. Mayflower Corporation owns 99.89% of the outstanding shares of RMFCC.

4. Non-Admitted Assets

Certain assets designated as "non-admitted" have been excluded from the balance sheet. The non-admitted assets are reflected as direct adjustments from net worth.

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

The total non-admitted assets as of December 31, 2001 consisted of the following assets:

Premiums and agents' balances in course of collection	\$ 240,537
Federal and foreign income tax recoverable and interest thereon	846,430
Prepaid expenses	24,960
Other assets	<u>142,848</u>
Total	<u>\$1,254,775</u>

5. Losses and Losses Adjustment Reserves

The reserves carried by the Company for these liabilities were \$8,037,864 and \$1,197,387, respectively, as of December 31, 2001.

The OIC's actuarial staff recommended the following examination adjustments to reserves as of December 31, 2001:

	<u>Booked Reserve</u>	<u>Examination Adjustment</u>	<u>Restated Reserve</u>
Losses	\$8,037,864	\$1,309,000	\$9,346,864
Loss adjustment expenses	1,197,387	466,000	1,663,387

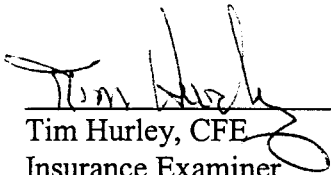
ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

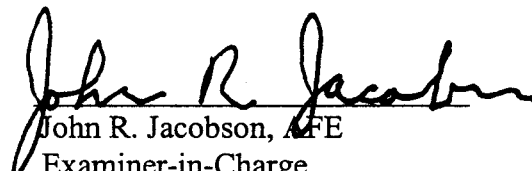
ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers of Rocky Mountain Fire & Casualty Company during the course of this examination.

In addition to the undersigned, D. Lee Barclay, FCAS, MAAA, Actuary; Keith D. Henderson, CPA, CFE; Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Jeanette Liao, MSF; Tarik M. Subbagh, CPA, MSBA; all from the Washington State Insurance Commissioner's Office, participated in the examination and the preparation of this report.

Respectfully submitted,


Tim Hurley, CFE
Insurance Examiner
State of Oregon


John R. Jacobson, AFE
Examiner-in-Charge
State of Washington

ROCKY MOUNTAIN FIRE & CASUALTY COMPANY

AFFIDAVIT

STATE OF WASHINGTON

}

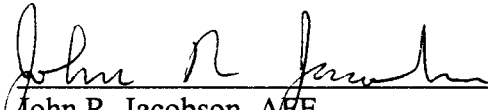
} ss

COUNTY OF THURSTON

}


John R. Jacobson, AFE, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

He attests that the examination of Rocky Mountain Fire & Casualty Company was performed in a manner consistent with the standards and procedures required or prescribed by the Washington Office of Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).



John R. Jacobson, AFE
Examiner-in-Charge
State of Washington

Subscribed and sworn to before me this 31st day of July, 2003.



Notary Public in and for the
State of Washington.

